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Women and Minority Investors Are Taking Matters into Their Own Hands

# Investors Are Taking Matters into Their Own Hands

The VC industry continues to pay lip service to diversity.

By Waverly Deutsch May 10, 2021 CBR – Entrepreneurship

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Credit: Kotryna Zukauskaite

Several recent studies point out that the COVID-19 pandemic is taking a greater toll on women in the workforce than on men. In this respect, the startup world is no different. A December 2020 headline from *Crunchbase News* tells the story: “Global VC funding to female founders dropped dramatically this year.” This in the same time frame during which global VC investments grew 15 percent year over year, to \$259 billion, and US investments reached an all-time high of \$130 billion, according to a PwC and CB Insights report.

When I last wrote about female founders and how much venture capital they received versus male founders (“What venture capitalists can learn from ‘racist’ rats”), women-only teams were getting a paltry 2.6 percent of the VC dollars, while all-male teams took home 87 percent. I wondered: How much lower could it go?

Digging into the data, I learned that investment in female-only founding teams hit a high-water mark in 2019 —of 3.4 percent of VC dollars, before falling to 2.4 percent in 2020. Funding to mixed-gendered founding teams dropped from 13 percent in 2017 to 9 percent in 2020, which still leaves an astounding 87 percent of funding going to all-male founding teams. VCs invest in people who look like themselves, and data indicate that they do this even though it hurts portfolio performance. Research

by Harvard's Paul Gompers and Silpa Kovvali finds that VCs that increased their proportion of female-partner hires by 10 percent saw, on average, a 1.5 percent improvement in annual fund returns and a nearly 10 percent increase in profitable exits.

Nevertheless, women appear to have made little to no progress in venture capital in the past four years, despite the persistence in the industry of the buzzword *diversity*. According to research conducted by Deloitte, the National Venture Capital Association, and Venture Forward this past March, the number of venture firms with diversity initiatives increased from 24 percent in 2016 to 43 percent in 2020. Forty-one percent of the VCs interviewed reported that their limited partners—the high-net-worth individuals, pension funds, family offices, corporate investment arms, and other institutions that supply the capital that VC funds invest—now asked about their diversity strategies.

The same report indicates that women currently make up 23 percent of investment professionals and 16 percent of the partners at venture firms, up from 9 percent of partners 20 years ago—although research from Women in VC, a global community of women venture investors, suggests that the actual percentage of female VC partners may be much lower, finding that just shy of 5 percent of VC partners are women. Why haven't these initiatives and new cohorts of women investors affected the funding going to female founders?

Maybe they have, just in a surprising way, producing results yet to be seen in the data.

# 'Sisters are doin' it for

# themselves'

In response to this situation, many women appear to be going out on their own. As the Eurythmics song goes, "Sisters are doin' it for themselves." Some 140 new women-led investment funds launched in the past four years, more than doubling the number that existed before 2017, according to the Women in VC report. Half of the women partners in the survey said they had started their own firm. These emerging managers, as the VC industry calls new fund managers, are investing from small first funds and are heavily focused on seed- and early-stage deals.

In March 2021, I had a chance to engage with a dozen of these women to find out what motivated their decisions to start their own venture firms. Most are fairly new to the game, having launched their funds in 2020 or 2021, with the oldest firm dating to 2015. All but one of the women are focused on seed- and early-stage investing. A third are investing from small funds, with less than \$10 million, but two of them are on a second or third fund with assets under management of \$21 million to \$50 million. The remainder manage funds that have \$10 million–\$20 million. These women have invested in 174 portfolio companies so far, and several have seen successful exits, with one reporting that her fund had already invested in two unicorns (private companies with valuations of over \$1 billion). Despite the fact that only three of the investors have a gender-specific investment thesis, 64 percent of the startups in this portfolio group have a female founder, and 18 percent have an underrepresented minority (Black, Latinx, or indigenous) founder. All told, their aggregate portfolio shows a very different profile from the traditional VC industry.



# Building up their own funds

While the venture-capital industry as a whole has made poor headway in terms of leadership diversity over the past decade, the number of funds started by women or by Black or Latinx founders has risen considerably.

**275 VC funds led by women**  
By time of formation

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Deutsch, 2021; Women in VC, 2020


A Flourish chart  

## 55 VC funds with Black or Latinx founders

By time of formation



Deutsch, 2021

✳ A Flourish chart 

Two-thirds of these investors considered joining an existing VC firm before launching their own funds, but chose to go it on their own for a variety of reasons. Nearly half mentioned wanting to build their own company and be the decision maker rather than join someone else's firm and have less say in the investment thesis or process. Others were aware that they had nontraditional backgrounds that would not get them in the door at most VC firms. Even when women have a more typical VC résumé, it is difficult for them to be seen in the same light as male candidates. For example, one woman who had experience in commercial banking and several years of corporate venture investing was asked by a company where she interviewed if she would consider an investor-relations job instead of one on the investment team.

All of the women I spoke with expressed how difficult it is to raise money for their funds. Their early LPs tended to be high-net-worth individuals. In one case, several early investors were successful founders the woman had worked with at previous venture funds, and they wanted to back her when she went out on her own. Another was financed by a single LP, a family office with a mission of

supporting women entrepreneurs. One woman told me that raising her first fund required more than 1,000 conversations. Many said that LPs (especially larger foundations, corporate investors, and pension funds) frequently commented that the women's funds were too small and didn't have enough of a track record, and two stressed that most institutional investors won't look at emerging female VCs unless they have been partners at large, top VC firms.

# The impact of emerging managers

What has this surge of new women-led VC funds meant for female entrepreneurs? Despite a 25 percent decline in overall funding to women-only startup teams, the number of deals done declined by only 18 percent. With more women creating venture funds to encourage female entrepreneurs at the earliest stages of their journeys, more deals are being done at the top of the funnel—the earliest startup stages—where the amount of capital deployed is the smallest. But that early financing can make all the difference between hitting key milestones and failing to launch.

The female investors I interviewed said they had no trouble finding good deals. Their diverse paths to venture capital gave them strong networks that were different from their male counterparts', plus the female entrepreneurs they were meeting had a lot of difficulty getting in front of the guys. At the same time, a couple of them noted that once female entrepreneurs had achieved significant milestones in their businesses, it was too late for their own small funds to get into the round. The guys had taken notice of these successful companies and priced the young funds out of the deal. Anecdotally, this

implies that if women-led VCs can nurture more female entrepreneurs through the early funding desert, more women-led companies will attract conventional growth-stage capital successfully. Of course, this remains to be seen.

## **A truly diverse startup ecosystem is now developing in the hands of women, minorities, and A.I.**

Women aren't the only group of investors taking the issue of diversity into their own hands. Harlem Capital Partners, a Black-owned VC firm founded in 2015, conducted research to identify Black and Latinx venture capitalists, a rare breed that together account for only 7 percent of venture partners. Their report identifies 200 investors, of whom half are at the partner level in their funds. Unsurprisingly, 80 percent of the partners are at funds they themselves started, and from what I see, most of these funds have been created in the past decade. I was able to identify 55 Black- or Latinx-founded VC firms, all but 10 founded since 2010.

# **Can we get beyond diversity lip service?**

When it comes to gender diversity, inertia seems to be the strongest force in this industry. According to the VC Diversity Index from the tech news site the *Information*, 41 of the 102 largest VC companies have zero women partners. The situation is even worse for underrepresented minority investors, as only 16 of those largest 102 companies have one or more Black or Latinx partners. The Deloitte report indicates an increase in female investment professionals over the past four years, but if the majority of the new underrepresented minority and women investment partners are self-made, are establishment VCs changing at all? The report also showcases the lack of change in the number of Black investment professionals, at 3 percent, and the decrease in Latinx investors, from 5 percent in 2018 to 4 percent in 2020.

Some large LP investors have created emerging-manager programs and dedicated to them a small portion of their overall investment capital. However, considering that they often define *emerging manager* as any VC firm with fewer than three funds under its belt, they are still looking for a new VC firm to have a significant track record before they will consider an investment. And as several of the women I interviewed pointed out, when female and minority managers are shunted off to the emerging-manager program, they are kept away from the decision makers who write the biggest checks.

These programs can also hide bias in how asset allocators evaluate emerging managers. Many LPs anticipate lower returns from these so-called emerging investments, perceiving them as riskier than allocations to established funds, even though first funds are more likely to see 25 percent or higher returns than later funds. Further, a group of researchers from Stanford and Illumen Capital modeled profiles of emerging managers raising their third venture fund, demonstrating that asset managers don't perceive white and Black fund managers the same way. When submitting fictitious profiles to asset allocators for evaluation, they altered only the race of the managing partner. Profiles of successful funds, indicated by previous fund returns, the number of exits, and partner



credentials, were given lower ratings on fund performance, investor skills, overall competence, social fit, expectations of how much the team would be able to raise, and likeliness that managers would take a meeting with the team when the managing partner was Black, the researchers found.

# Is technology the diversity silver bullet?

As I was conducting this research, I came across an interesting early-stage VC firm out of Covington, Kentucky, called Connetic Ventures that is taking a different approach. Connetic was founded by Brad Zapp, a white man whose thesis was to let technology do all the prescreening for the fund's deals. He and his team built an artificial-intelligence engine they named Wendal, embedded in it the deal characteristics they believed would lead to good investment opportunities, and trained the engine on data from 100 companies where the outcomes of success or failure were known.

Wendal has been refined with data from 3,000 startups over the past four years, and the results are fascinating: 52 percent of the startups that Wendal has recommended for further due diligence have either a female or nonwhite founder. Gender and ethnicity are not variables that the algorithm considers, so Connetic discovered this statistic when they analyzed Wendal's results. It turns out that Wendal recommends female and nonwhite founders at about the same proportion that those founders apply to Connetic and go through their screening process, which counters the myth that there aren't enough good female and minority entrepreneurs for VCs to fund. Connetic's portfolio reflects this diversity, with 36 percent of its

companies led by female CEOs, and 18 percent by people of color.

Connetic isn't the only venture capitalist trying this approach. San Francisco-based SignalFire and EQT Ventures out of Stockholm have also built A.I. engines that are directing parts of their investment process. Technology research firm Gartner predicts that three-quarters of VCs will be using A.I. to make at least some of their investment decisions by 2025. If Gartner is correct, it appears that—the established industry's lip service to diversity notwithstanding—a truly diverse startup ecosystem is now developing in the hands of women, minorities, and A.I. Take note of that, entrepreneurs. So much for the old boy network.

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Waverly Deutsch is clinical professor at Chicago Booth.

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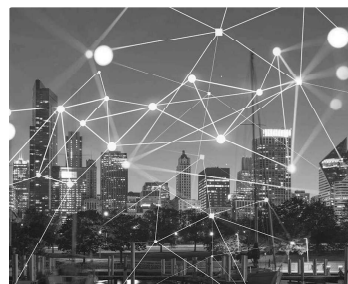
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